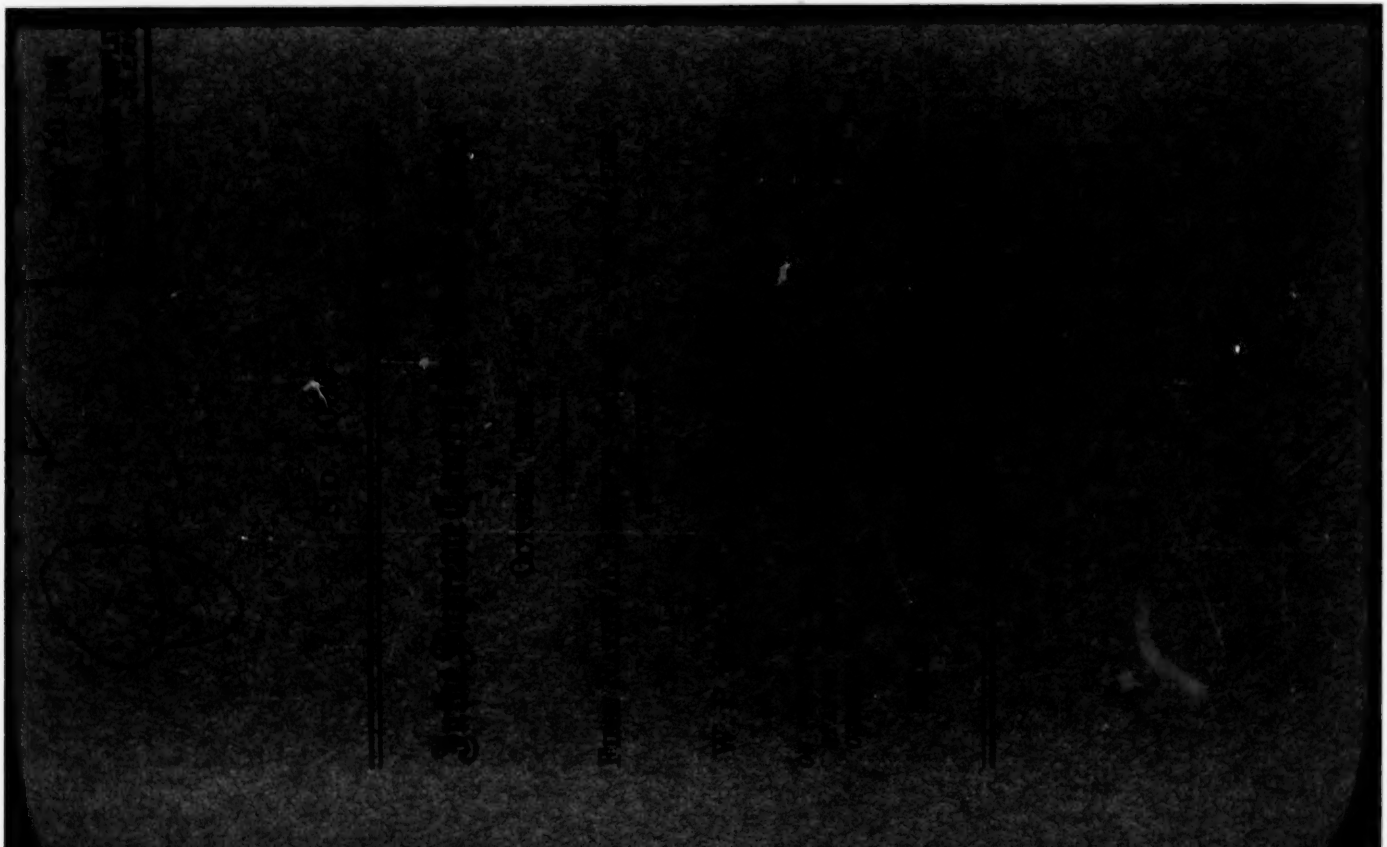

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 1065

FIRST NATIONAL BENEFIT SOCIETY, A CORPORATION, PETITIONER

v.

W. P. STUART, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The District Court for the District of Arizona wrote no opinion. Its findings of fact and conclusions of law are found in the record at pages 36–44. The opinion of the Circuit Court of Appeals (R. 290–293) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 11, 1945. (R. 293–294.) A petition for rehearing was denied on January 11, 1946. (R. 294.) A petition for writ of certiorari was filed on April 5, 1946. The jurisdic-

tion of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the taxpayer, during the calendar year 1938, was a life insurance company, as defined by Section 201 (a) of the Revenue Act of 1938.

2. If not, whether the taxpayer is entitled to additional deductions for premium deposits under Section 207 (c) (3) of the Revenue Act of 1938.

STATUTES AND REGULATIONS INVOLVED

The statutes and Regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The facts found by the District Court may be summarized as follows:

The taxpayer was incorporated in 1934, under the laws of Arizona as a mutual benefit association. Its primary purpose was to provide funds for the burial of deceased members. Seven classes of certificates or policies outstanding in 1938 totaled approximately 10,000. The benefits or insurance in force aggregated approximately $3,765,595 on December 31, 1938. (R. 36–37.)

The financial statement attached to the taxpayer's return showed the following as of December 31, 1938 (R. 37):

ASSETS

Cash	$7,049.30
Deposit with state	2,000.00
Furniture and fixtures	1,951.73
Deferred charges	57.00
Total	$11,058.03

LIABILITIES

Surplus	4,895.54
Mortuary income account—life	6,162.49
Total	$11,058.03

The taxpayer kept a bookkeeping record allocating a portion of its premium receipts to the "mortuary reserve," but it maintained only one bank account and the deposits were not segregated. The general fund, under the by-laws, was to be used for expenses not payable out of the mortuary fund, and the mortuary fund was to be used for the payment of claims, taxes, attorney's fees, the deposit required by the State of Arizona, and such expense charges as should be fixed by the board of directors for the handling of claims. The certificates recited the by-law provision requiring 50% of premiums after the first year be deposited in a reserve fund. (R. 38.)

Taxpayer was managed during 1938 and prior years by M. C. Reese, his wife, and a brother, who were president, vice-president, and secretary-treasurer, respectively. These also constituted the board of directors. Two directors constituted a quorum for the transaction of business and the by-laws could be altered at any meeting by a two-thirds vote of the directors. The directors were em-

powered to appoint and remove at pleasure all officers and employees and could expel any member at any time for any cause sufficient in their judgment with or without notice to such member. Funds were dispensed upon the check of M. C. Reese as president. Officers' salaries aggregated $7,500 in 1936, $9,750 in 1937, and $15,900 in 1938. The latter compensation was paid $13,500 to M. C. Reese and $2,400 to his brother. These officers received travel allowances of $2,200 in 1936, and $2,400 in 1937 and in 1938. From these facts the District Court concluded that it was inferable that the taxpayer was operated for the benefit of the controlling director-officers rather than for the purpose of providing insurance to its members at cost. (R. 40.)

Membership in the taxpayer was not limited under its by-laws to persons holding benefit certificates; it was permissible to acquire membership, to vote and to hold office upon payment of certain minimum dues, and agents soliciting memberships could become "Honor" members entitled to any entertainment privileges or the use of any lodge or other headquarters maintained by the taxpayer. (R. 41.)

The facts and question in this case are substantially the same as those previously decided by the Federal District Court for the District of Arizona in *First National Benefit Society* v. *Stuart,* on March 4, 1942 (30 A. F. T. R. 1659), affirmed, 134 F. 2d 438 (C. C. A. 9th), certiorari

denied, 320 U. S. 211, relating to the taxpayer's income tax liability for 1936 and 1937. (R. 42.)

The Commissioner determined that the taxpayer's taxable net income for 1938 was $10,139.48 and that its income tax liability was $1,673.01. The taxpayer paid the tax assessed by the Commissioner, together with interest, on August 13, 1941, in the aggregate sum of $1,914.05, and thereupon filed a claim for refund of the tax and interest. After more than six months had elapsed without action on the claim by the Commissioner, taxpayer brought the instant suit. (R. 39.)

In its conclusions of law, the District Court held that the taxpayer did not maintain a "reserve fund" for the sole purpose of fulfilling its insurance contracts within the meaning of Section 201 (a) and the applicable Treasury Regulations. It also concluded that the deductions claimed under Section 207 (c) of the Revenue Act of 1938 were not allowable under the principle of *res judicata,* and that even if the principle were inapplicable, the taxpayer was not entitled to additional deductions for 1938 because the premiums received by it were not "premium deposits." The court concluded finally that the taxpayer had failed to sustain the burden of proving error on the part of the Commissioner. (R. 42–44.) The Circuit Court of Appeals affirmed on the ground that on neither issue had the taxpayer sustained its burden of proof. (R. 290–293.)

ARGUMENT

1. On the issue whether the taxpayer was a life insurance company within the meaning of Section 201 (a) of the Revenue Act of 1938 (Appendix, *infra*) the Circuit Court of Appeals held that the taxpayer had not sustained its burden of proving that it was within the statutory definition. (R. 292.) Those provisions require that a life insurance company must be:

> engaged in the business of issuing life insurance and annuity contracts, * * * the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

It cannot be denied, and the taxpayer does not undertake to do so, that it had the burden of proving the Commissioner's determination incorrect. *Reinecke* v. *Spalding,* 280 U. S. 227; *Botany Mills* v. *United States,* 278 U. S. 282; *United States* v. *Anderson,* 269 U. S. 422. In this posture no question arises as to the validity of Article 203 (a) (2)–1 of Treasury Regulations 101 (Appendix, *infra*), and the asserted conflict based on decisions of the Fifth, Eighth and Tenth Circuit Courts of Appeals invalidating portions of the regulation (Pet. 7–8) is unfounded.

The statute requires that reserve funds held for the fulfillment of life insurance contracts constitute fifty percent of its total reserve funds. Whatever in addition the term "reserve funds" may mean, as defined in the Regulations, the least

that the phrase, as used in the statute, requires is that a sum of money be set aside, "reserved," as a fund to meet obligations arising out of the insurance policies issued by the taxpayer. This was the meaning assigned to "reserve" by this Court in *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 350. The Fifth Circuit relied on this definition in interpreting the phrase, in a statute identical with the one involved here, and in arriving at the conclusion that the reserve must be a fund irrevocably set aside for the protection of the policy holders. The court concluded that "in a sense" the reserve "partakes of the nature of an inchoate trust for the benefit of policy holders." *General Life Ins. Co.* v. *Commissioner,* 137 F. 2d 185, 189, 190.

That there was no fund irrevocably set aside here for the protection of the policy holders is clear. The District Court found that although a bookkeeping record was kept allocating a portion of its premium receipts to the "mortuary reserve," the company maintained only one bank account and deposits were not segregated. Moreover, under the by-laws, the "mortuary fund" was to be used for the payment of claims, taxes, attorneys fees, the deposit required by the State of Arizona and such expense charges as should be fixed by the board of directors for the handling of claims. (R. 38.) The Court concluded that the taxpayer did not maintain a "reserve fund" and even if it had, the fund could be used for

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purposes other than the fulfillment of insurance contracts as required by Section 201 (a). (R. 43.) This uncontested conclusion is amply supported by the record, and on familiar principles is conclusive on review. *McCaughn* v. *Real Estate Co.*, 297 U. S. 606.

Although the Circuit Court of Appeals in this case did not rely on the Treasury Regulations, they furnish additional support for the decision herein. Article 203 (a) (2)–1, Regulations 101, provides:

> In general, the reserve contemplated is a sum of money, variously computed or estimated, which, * * * is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims.

These provisions are patterned after the definition contained in *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 350. This interpretation adopted in the Regulations is reasonable. Its validity is confirmed by the successive re-enactments of the Revenue Acts [1] (see *Helvering* v. *Winmill*, 305 U. S. 79, 83), and no court has challenged it.

The alleged conflict posed by *General Life Ins. Co.* v. *Commissioner, supra; Abilene Life Ins.*

[1] Article 203 (a) (2)–1 of Treasury Regulations 94 and 86 under the 1936 and 1934 Acts, respectively, are the same. Similar provisions have appeared in all Regulations since the enactment of the Revenue Act of 1921. See Article 681 of Treasury Regulations 62, 65 and 69; Article 971 of Treasury Regulations 74 and 77.

Co. v. *Commissioner,* 137 F. 2d 191 (C. C. A. 5th); *Jones* v. *Oklahoma Ben. Life Ass'n,* 151 F. 2d 505 (C. C. A. 10th), and *Swift & Company Employes Benefit Ass'n* v. *Commissioner,* 151 F. 2d 625 (C. C. A. 7th), does not exist. The *General Life* case threw doubt on the validity of the regulation's actuarial requirements for a reserve fund but as we have already shown the Court stated that the fund was in the nature of a trust and accordingly the case supports the result of the court below. The companion *Abilene* case was decided on the same basis. *Oklahoma Benefit Life* was expressly limited to the question whether interest which did not accrue to the reserve fund is a use of the fund other than for the payment of claims arising out of the policies and the *Swift and Company Employees* case turned solely on the requirement of the regulation that the reserve be required by law.

Finally, the question of the validity of the entire regulation, even were it presented by this case, is of diminishing importance because its provisions were largely adopted in the definition of "life insurance reserves" in Section 201 (c) (2) of the Internal Revenue Code, added by Section 163 (a) of the Revenue Act of 1942.

2. Taxpayer lists as a question presented whether it is entitled to a deduction under Section 207 (c) (3) (Pet. 7) of the Revenue Act of 1938 (Appendix, *infra*), but no reason is assigned for

issuance of the writ on this issue (Pet. 7–8) and none appears in the supporting brief. We believe there are none. Even were there otherwise sufficient reason for issuance of the writ, it should not be issued in this case because the same issue was litigated between the parties to this case for 1936 and 1937 in *First Nat. Ben. Soc.* v. *Stuart,* 134 F. 2d 438 (C. C. A. 9th), certiorari denied, 320 U. S. 211 (R. 42, 43) and accordingly is *res judicata. Tait* v. *Western Md. Ry. Co.,* 289 U. S. 620.

CONCLUSION

There is no conflict of decisions and the decision of the court below is correct. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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MAY 1946.